

Message Text

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ACTION EB-11

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SUBJ: THE BUSINESS CLIMATE--- DEEPENING CONCERN

SUMMARY:HONG KONG'S TRADITIONAL GRIPING ABOUT BUSINESS CONDITIONS IS ACQUIRING A RING OF AUTHENTICITY. FOR THE FIRST TIME SINCE 1967, A SIZEABLE MINORITY OF THE BUSINESS COMMUNITY EXPECTS TRADE AND PRODUCTION TO DECLINE SIGNIFICANTLY AND FOR AN EXTENDED PERIOD. THIS IS DIRECTLY ATTRIBUTABLE TO THE SOFTENING OF THE COLONY'S PRIMARY EXPORT MARKETS AND TO A DOWNTURN IN REAL ESTATE--- ONE OF THE FEW INDUSTRIES NOT DIRECTLY DEPENDENT UPON EXPORTS. ON THE OTHER HAND, HONG KONG HAS REMAINED COMPETITIVE AND LOOKS FORWARD TO SUBSTANTIALLY BETTER PERFORMANCE WHEN ITS MARKETS IMPROVE. END SUMMARY.

1. CRYING ALL THE WAY TO THE BANK IS A POPULAR PASTIME FOR HONG KONG BUSINESS MEN AND THE CONGEN HAS, ACCORDINGLY, TENDED TO DISCOUNT QUITE HEAVILY SENSATIONAL PRESS REPORTS OF THE IMMINENT COLLAPSE OF ONE INDUSTRIAL SECTOR OR ANOTHER. IN THE PAST THREE WEEKS, HOWEVER, THE BUSINESS CLIMATE HAS

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TAKEN A PRONOUNCED TURN TOWARD GLOOM. PERHAPS COINCIDENTALLY,

I.E., THERE WAS NO DIRECT, OBJECTIVE ECONOMIC CAUSE, THE HANG SANG INDEX OF STOCK VALUES FELL TO 235, THE LOWEST FIGURE SINCE MAY 1971 N, WHEN THE ILL-FATED STOCK BOOM BEGAN. THE PERIOD HAS ALSO BEEN CLOUDED WITH REPORTS OF FINANCIAL IRREGULARITIES IN ONE OF THE LARGEST LOCAL CONSTRUCTION FIRMS AND A SHARP DOWNTURN IN NEW CAR SALES (THE LATTER, HOWEVER, IS REALLY A FUNCTION OF SHARP INCREASES IN REGISTRATION AND PARKING FEES).

2. THE REAL CAUSE OF THE CONCERN IS THE PROSPECT OF DECLINING EXPORT PERFORMANCE. EXPORTS HAVE HELD UP FAIRLY WELL DURING THE FIRSTSEVEN MONTHS: THEY INCREASED ALMOST 40 PERCENT IN VALUE AND AN ESTIMATED 4 PERCENT IN VOLUME. IN THE PAST FEW WEEKS , HOWEVER, SEVERAL SIGNIFICANT TEXTILE AND ELECTRONIC ORDERS FROM THE U.S. HAVE BEEN CANCELLED. OTHERS HAVE FAILED TO MATERIALIZE. THESE HAVE HAD AN IMPORTANT PSYCHOLOGICAL IMPACT NOT ONLY FOR THEMSELVES, BUT BECAUSE THE BUSINESS COMMUNITY HAS BEEN WHISTLING IN THE DARK ALL YEAR, SAYING THAT CURRENT CONDITIONS WERE SOFT BUT THAT FALL ORDERS WOULD IMPROVE MATTERS. NOW, THE PROSPECT IS, INSTEAD, A FALL DOWNTURN FOR ALL BUT A FEW COMPANIES. ADDED TO ITS PROBLEMS WITH THE U.S. MARKET HAS BEEN A FRUSTRATING INABILITY TO COMPENSATE WITH INCREASED EXPORTS TO WESTERN EUROPE (ONLY BELGIUM/LUXEMBOURG REGISTERED REAL VOLUME INCREASES).

3. THE PICTURE IS , OF COURSE, VERY MIXED. DESPITE A DECLINE IN THE VOLUME OF GARMENT EXPORTS AND THE CLOSURE OF HUNDREDS OF HOLE-IN-THE-WALL GARMENT FACTORIES, THE BIGGIES TELL US THEY ARE IN RELATIVELY GOOD SHAPE AND CAN WEATHER A LONGISH DOWNTURN. THE TEXTILE SECTORS THAT ARE HURTING ARE SPINNING ANDWEAVING; THEY ARE BITTER ABOUT TAIWAN'S KOREA'S, AND PAKISTAN'S "DUMPING" OF YARNS AND FABRICS AND HAVE ASKED FOR GOVERNMENT INTERVENTION. THESE SAME SECTORS, HOWEVER, ENJOYED THEIR HIGHEST PROFITS IN 1973 SINCE THEIR FOUNDATION. THE SAME STORY HOLDS FOR ELECTRONICS. PRODUCERS OF FINISHED RADIOS AND OTHER CONSUMER ITEMS ARE HURTING, WHILE COMPONENT AND MEMORY CORE PRODUCERS ARE EXPANDING SALES. THE PLASTICS SECTOR IS SUFFERING A GENERAL DOWNTURN; BUT, AGAIN INNOVATIVE TOY PRODUCERS ARE DOING WELL. SOME LIMITED OFFICIAL USE

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OF WHAT WE SEE IS A REPLAY OF THE ADJUSTMENTS WHICH TOOK PLACE IN 1970 AND 1971 IN THE FACE OF A U.S. RECESSION, BUT THIS TIME BOTH THE U.S. AND EUROPEAN MARKETS ARE SOFT AND THE ADJUSTMENTS, ACCORDINGLY, ARE MORE SEVERE.

4. THE TWO LOCAL INDUSTRIES THAT DO NOT DEPEND UPON EXPORTS, REAL ESTATE AND TOURISM, HAVE SHOWN MARKEDLY LOWER PROFITS IN 1974. WHILE SOME HAVE BLAMED 1973 RENT CONTROL LAWS,

THESE DO NOT APPLY TO COMMERCIAL PREMISES AND THE REAL ESTATE SECTOR SEEMS TO BE SUFFERING FROM STATIC DEMAND. TOURIST ARRIVALS WHICH HAVE BEEN INCREASING BY 20 PERCENT P.A. IN RECENT YEARS, ARE NOW ONLY 5 PERCENT AHEAD OF A YEAR AGO, AND TOURISTS SEEM TO BE SPENDING LESS PER CAPITA. HOTELS ARE OPERATING AT 60 PERCENT CAPACITY WHICH IS ABNORMALLY LOW FOR HONG KONG AND TOO LOW TO MEET THEIR HIGH LEVERAGE FINANCING. TOURIST SHOPS IN HOTEL ARCADES AND OTHER HIGH RENT AREAS ARE CLOSING DOWN AT A DISQUIETING RATE.

5. COMMENT: DESPITE AN ADMITTEDLY DIFFICULT SITUATION, WE WOULD NOT CONFUSE THE CURRENT PESSIMISM WITH DESPAIR OR PANIC. HONG KONG PRODUCERS ARE WELL AWARE THAT THEIR COMPETITORS ARE IN THE SAME BOAT AS FAR AS TIGHT MONEY AND RAW MATERIAL COSTS ARE CONCERNED AND THAT HONG KONG HAS MAINTAINED A COMPETITIVE POSITION, AT LEAST VIS-A-VIS OTHER ASIAN PRODUCERS. THEY ARE CONFIDENT THAT WHEN CONDITIONS IN THEIR MARKETS IMPROVE, THEIR PERFORMANCE WILL RISE ACCORDINGLY.

6. THE LABOR SITUATION WILL BE DISCUSSED IN A SEPARATE TELEGRAM.
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